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
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Demand for Islamic Financial Services in the UK: Chasing a Mirage?

HUMAYON A. DAR[♦]

Abstract

This paper attempts to quantify demand for Islamic financial services in the UK. Using a sample of over 500 respondents, it develops a demand index that incorporates information on religious belief, economic factors and bank selection criteria. The main finding is that while there is no huge demand for Islamic finance at present, it is certainly growing and is expected to further increase if correct marketing measures are adopted. The paper also employs Logit regressions to determine the factors affecting such a demand. South-north divide, income, educational attainment and occupation are found to affect demand for Islamic finance in the UK.

Keywords

Islamic financial services, demand index, bank selection criteria

[♦] Lecturer, Department of Economics, Loughborough University, Loughborough, Leicestershire LE11 TU, UK; phone: +44 1509 222709; fax: +44 1509 223910; email: M.H.A.Dar@Lboro.ac.uk.

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1. INTRODUCTION

Recent surge in interest in Islamic banking and finance in the United Kingdom is consistent with growing popularity of this type of banking in other countries.

London, as an international financial centre, attracts significant Islamic funds through investment banks and other financial intermediaries having business links with the Middle East. However, the domestic Islamic market remained untapped until recently when an increasing number of banks, including Ahli United Bank (through its London branch and in collaboration with West Bromwich Building Society), United National Bank, HSBC, and some others¹ started offering Islamic mortgages to Muslims living in the UK. Moreover, the Islamic Bank of Britain, a fully-fledged Islamic bank, has just received a licence from the Financial Services Authority (FSA) to open its branches in major British cities (August 2004).

While some argue that there is significant demand for Islamic financial services in the UK [Datamonitor, 2002], there are reasons to believe that the demand for Islamic financial services indeed may prove to be a mirage. Although Muslims living in the UK indicate strong desire for Islamic financial services, it may not follow that significant effective demand for such services actually exist at the grassroots level. For example, the closure of Al-Baraka Bank in the early 1990s and failure to attracting sufficient clientele by Halal Mutual Investment Company in the mid 1990s may substantiate the view that British Muslim community is not sufficiently financially sophisticated (and informed) to consume Islamic financial services, which require some basic knowledge of the Shariah (the Islamic law) and Islamic economic doctrine. The weak performance of iHilal Financial Services at the end of 1990s represents the continuity of this trend². There may not be an automatic demand for

Islamic financial services even in the predominantly Muslim countries [see Ahmad and Haron, 2002; and Erol and El-Bdour, 1989].

Following some extensive media coverage³, there is now a definite increase in the awareness of Islamic finance and many financial institutions contemplate tapping the so-called “pent-up” demand for Islamic finance in the UK and in other European markets. Increase in number of providers of Islamic financial services in the UK should add to the competitiveness of this sub-market; necessitating even a closer look at the behaviour and attitude of Muslims towards financial services in general and Islamic finance in particular.

This paper focuses on the fundamental issues like awareness and perception of Islamic finance in the British Muslim community, with a view to quantifying demand for Islamic financial services in the country, and then determining the factors that may affect this demand. This research will be of interest to both incumbent and potential entrants into this niche market. Government departments like the HM Treasury, FSA and other policymaking authorities are also expected to benefit from the policy implications of this research. The issue of social exclusion of British Muslims is also of some relevance, as this research attempts to explore Islamic influence on demand for financial services by Muslims living in the UK. If the religion influences decision-making in the choice of financial services (e.g., not investing on interest-basis following the prohibition of interest for Muslims) and the system does not provide interest-free financial services, this may indicate social exclusion of the UK Muslims. But, if Muslims are primarily motivated by economic incentives as suggested by neo-classical economics, then the argument of social exclusion on religious grounds is a bit too exaggerated.

The next section briefly reviews the existing related literature. Section 3 discusses research methodology, data collection and modelling of demand for Islamic financial services. Section 4 describes data analysis and discusses some important results. In addition to the demand index, it also discusses the results from Logit regressions. Section 5 discusses some strategic implications and concludes.

2. REVIEW OF LITERATURE

There is a paucity of research on estimation of demand for Islamic financial services. Even a few studies that exist on the topic are mainly concerned with the bank selection criteria and not with market aggregate for Islamic financial services. Metawa and Almosawi [1998] study banking behaviour of customers of two Islamic commercial banks operating in Bahrain at that time. They assert that adherence to Islamic Shariah is the main motivating factor to custom with Islamic banks. This is in contrast with Erol and El-Bdour [1989] who observe that religious motivation is not a primary criterion for the selection of Islamic banking services in Jordan. Naser, Jamal and Al-Khatib [1999] observe that 70 percent of Muslims accord importance to religious issues when choosing an Islamic bank in Jordan. Ahmad and Haron [2002], although limited in scope as it is based on a sample of only 45 corporate users of financial services, indicate that a majority considers religious as well as other factors (like cost/benefit, service delivery, reputation, and location etc.) when making decisions on bank choice. This confirms their earlier study that concludes that there are no significant differences between Muslims and others in Malaysia in their choice of a bank [Haron, Ahmad and Planisek,1994]. Gerrard and Cunningham [1997], in their study of Islamic banking in Singapore, observe that about two-third of Muslims consider religious as well as economic factors in deciding to custom with an Islamic bank.

Overall, the results from empirical studies indicate that demand for Islamic financial services is perhaps influenced by both religious and economic factors. However, one must recognise that the differing responses may very well be due to heterogeneity in questionnaire design and methodology. Close-ended questionnaires are limited in scope, as they may amount to “putting words into respondent’s mouth.” As these studies do not attempt to quantify demand for Islamic financial services on an aggregate level, any inference in support of demand for Islamic finance should be considered with caution. There is a difference between bank selection criteria and demand for Islamic finance on an aggregate level, which needs to be considered while assessing demand for Islamic financial services. Previous studies, however, do not make such a distinction.

3. RESEARCH METHODOLOGY

The paper is based on data collected through personal interviews and the use of a questionnaire. We chose 10 English cities with significant Muslim populations, including London, Birmingham, Manchester, Nottingham, Leicester, Coventry, Derby, Peterborough, Loughborough and Luton. 11 surveyors who visited Muslim communities in these cities filled in most of the questionnaires during personal interviews⁴. A small number of questionnaires were sent out through ordinary mail. Personal visits were helpful in raising response rate. The surveyors were trained for conducting interviews among Muslims so that they did not create any bias in the participants’ response. Furthermore, the questionnaire was designed so as to minimise any bias in favour of Islamic finance. A particular bias to be minimised was the undue desire of respondents to pose themselves as devout Muslims against their actual behaviour⁵.

503 of 550 completed questionnaires were found useable; 47 were discarded owing to incompleteness or inconsistency. Table 1 summarises some basic statistics on age, ethnic origin and location of the respondents. There is quite a good mix of people ranging from below 18 years of age to over 65, although a bulk of the respondents belong to middle ages (26-49). Similarly, a number of ethnicities are represented including the white, but the south Asians dominate. Apart from Peterborough, all other cities are represented more or less proportional to the Muslim populations located therein. For example, Muslim population in London ranges from 11 percent (Haringey) to 36 per cent (Tower Hamlets) and our sample includes 21 percent of respondents from London. Similarly, about 13 percent of population in Manchester in Muslim, which is represented by 12 percent of the respondents in our sample.

Table 1: Distribution of respondents

| City | Number (percentage) | Age bracket | Number (percentage) | Ethnicity | Number (percentage) |
|--------------|------------------------|-------------|------------------------|-------------|------------------------|
| Manchester | 61 (12) | Below 18 | 15 (3) | White | 39 (8) |
| Nottingham | 48 (10) | 18-25 | 147 (29) | Indian | 76 (15) |
| Derby | 50 (10) | 26-33 | 161 (32) | Pakistani | 193 (38) |
| Loughborough | 50 (10) | 34-41 | 92 (18) | Bangladeshi | 88 (18) |
| Leicester | 60 (12) | 42-49 | 56 (11) | Black | 27 (5) |
| Peterborough | 2 (0) | 50-57 | 19 (4) | Arab | 47 (9) |
| Birmingham | 54 (11) | 58-65 | 9 (2) | Mixed | 27 (5) |
| Coventry | 28 (6) | 65+ | 4 (1) | Others | 6 (2) |
| Luton | 42 (8) | | | | |
| London | 108 (21) | | | | |
| Total | 503 (100) | | 503 (100) | | 503 (100) |

The questionnaire sought information on income, saving behaviour, investment criteria and borrowing (personal loans and mortgages) in addition to Muslims' awareness of Islamic financial institutions in the UK and the products offered by them. In addition, information on age, sex, race, educational attainment and other classificatory variables was sought. The survey also included some indirect questions, aimed at understanding respondents' true attitude towards Islamic finance and their demand for Islamic financial services.

3.1. Modelling Demand for Islamic Financial Services

One of the basic assumptions is that Islamic financial services should mainly attract Muslims, who represent about 3 percent of the UK population or about 1.8 million in number. Other communities may also be marginally interested. This is particularly true in the early stages of development of Islamic finance in a country. Later, with an increase in awareness of Islamic finance, non-Muslims also tend to patronise Islamic banks. This has certainly been a trend in countries like Malaysia where an increasing number of Chinese are using Islamic financial services, after an initial reluctance for over 15 years. Demand for Islamic finance in the UK is expected to follow this trend as non-Muslims will be unwilling to pay higher prices for Islamic financial services that have so far been dearer than their conventional counterparts.

Most demand models focus on deposit services (current, savings and time deposit accounts), excluding demand for loans and other services, as they appear to constitute a separate area of analysis [see, for example, Dick, 2002]. This paper, however, combines deposit services, loans and mortgages because the prohibition of interest in Islam implies a complete switching from conventional interest-based

services to the Islamic; although one may claim that current accounts offered by conventional banks are interest-free and, hence, should be Islamically acceptable.

Potential demand for Islamic financial services may be determined by three sets of factors: (a) demand for conventional financial services (denoted by **d**); (b) other concerns (denoted by **o**); and (c) awareness of Islamic finance (denoted by **a**). We construct a demand index based on these factors to find out how income, educational attainment, geographical location and some other related variables might affect demand for Islamic financial services.

The unit **d** is important because it takes care of sampling bias⁶. It is additive, i.e., $d = \sum_{i=1}^6 x_i$, where x_1 = current account, x_2 = savings account, x_3 = personal loan, x_4 = mortgage, x_5 = credit cards and x_6 = payments on credit cards, which take maximum values of $1/8$, $1/8$, $1/4$, $1/4$, $1/8$ and $1/8$, respectively. The unit **o** captures bank selection criteria, and is also additive, i.e., $o = \sum_{i=1}^5 y_i$, where y_1 = rate of return on investments/deposits, y_2 = location, y_3 = reputation, y_4 = service quality and y_5 = range of services offered by a bank, which may take a maximum value of $1/5$ each. The unit **a** is multiplicative-additive, i.e., $a = z_1(z_2 + z_3 + z_4)$, where z_1 = opinion on the prohibition of interest, z_2 = awareness of Islamic financial institutions, z_3 = awareness of Islamic modes of financing, and z_4 = opinion on Islamicity of Islamic financial institutions (z_{41}) and their products (z_{42}), which may take maximum values of $5/3$, $1/5$, $1/5$ and $1/5$, respectively. $z_4 (=1/5)$ is equal to $z_{41} + z_{42} = 1/10 + 1/10$. The opinion on the prohibition of interest (z_1) constitutes the respondent's belief in the prohibition of interest (z_{11}) and their use of a credit card (z_{12}). This is augmented with holding of a conventional mortgage (z_{13}), and borrowing (personal loans) on interest basis (z_{14}).

We give z_{11} a weight of 5 and to z_{12} - z_{14} weights of $1/9$ each so that $z_1 = z_{11}(z_{12} + z_{13} + z_{14}) = 5/3$.

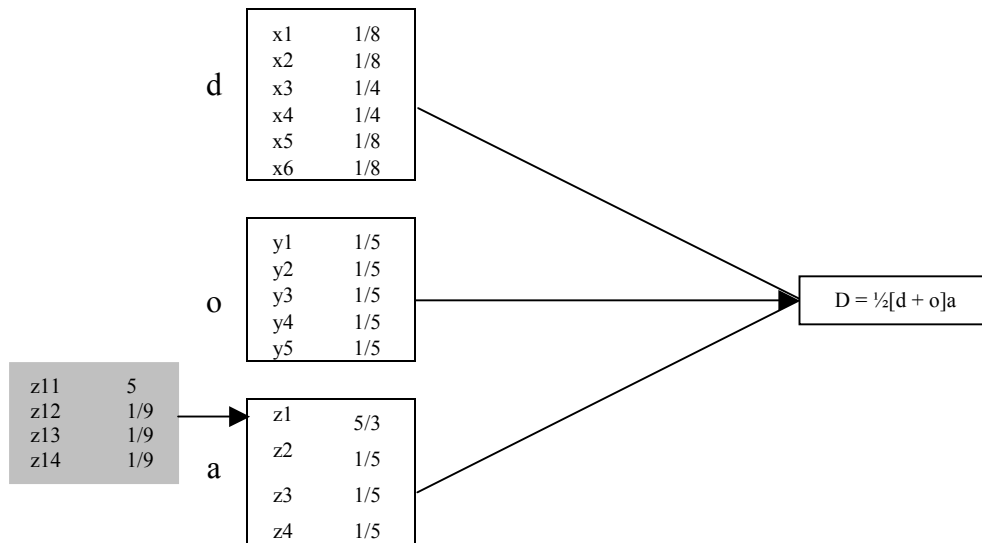
The weighting scheme reflects relative importance of these components in financial decision-making. For example, current (x_1) and savings (x_2) accounts take values of $1/8$ each, which are less than the value of $1/4$ attached to personal loans (x_3) and mortgages (x_4) each. This is because the decisions to mortgage a property and obtain personal loans are much more important and deliberate than deciding to open a current or savings account. The components of \mathbf{o} take equal weights because different individuals may take them equally important. The unit \mathbf{a} has a multiplicative-additive structure. Perhaps the most crucial component of all the units is z_1 , i.e., opinion on the prohibition of interest. If a person does not believe in the prohibition of interest-based banking system, there are very slim chances that they will switch to an interest-free (i.e., Islamic) banking system. To capture this importance we use it in multiplicative form with the sum of other three components, so that a non-believer in the prohibition of interest should not be taken as having some effective demand for Islamic financial services. For a sketch of our methodology, see Figure 1.

Thus, demand index for Islamic financial services can be written as a multiplicative-additive function:

$$D = \frac{1}{2}(d + o)a$$

As $\mathbf{d}, \mathbf{o}, \mathbf{a} \in (0, 1)$, $\mathbf{D} \in (0, 1)$; we divide the expression on the RHS by 2 to ensure that $\mathbf{D} \in (0, 1)$.

Figure 1: Construction of demand index and its constituents



The basic idea behind this modelling is to find out how willing a Muslim was to switch, partially or fully, from their existing banks to an Islamic one, if they had a choice⁷. There is strong evidence against switching banks in the UK [Gondat-Lerralde and Nier, 2004; Cook *et al*, 2002]. Hence, willingness to switch should provide a good indicator of demand for Islamic financial services. Although the literature on bank selection criteria [Anderson *et al*, 1976; Erol and El-Bdour, 1989; Haron *et al*, 1994; Gerrard and Cunningham, 1997; Metawa and Almosawi, 1998; and Naser *et al*, 1999] serves a general guideline for conducting research into demand for Islamic financial services, there is a need to differentiate between choosing a bank and deciding to use financial services of a particular type. While factors like the advice and recommendation of family and friends, convenience of location, friendliness of personnel and customer services quality may play an important role in bank selection, these criteria, however, can only be of secondary importance when opting for Islamic financial services. This is because the decision to switch lies in the belief that interest

is prohibited and, hence, should be avoided. Although awareness of Islamic financial institutions and the products offered by them influence the decision to switch, but perhaps it is more important that the individual is convinced that the institutions and products operate in conformity with the Islamic principles. There is some evidence that Muslims perceive Islamic banking to be more akin to social banking that aims at enhancing community welfare [Gerrard and Cunningham, 1997]. If so, then Islamic banks' commitment to social development is expected to influence the decision to switch. Some previous studies observe that customers of Islamic banks tend to give importance to the Islamic behaviour of banks [see, for example, Metawa and Almosawi, 1998] who assert that adherence to Islamic principles was the most important factor influencing the selection of Islamic banks in Bahrain) and Islamicity of financial services provided by them [Erol and El-Bdour, 1989]. In some other cases, it has proven to be of less concern [Haron *et al*, 1994]. Therefore, it is fair to assume that there are three types of Muslim customers: staunch believers in the prohibition of interest, 'pent-up' customers, and 'conventional' customers. The staunch believers are expected never to enter into interest-based transactions (and may have actually been prevented from using financial services in the UK – the possible case of social exclusion). The pent-up demanders consider religious and other factors in choosing a financial product and are expected to switch to Islamic financial services had these been sufficiently competitive vis-à-vis conventional products. The conventional category would in general be reluctant to use Islamic finance, particularly if it happens to be more costly (see Figures 2(a-c) for a graphical representation).

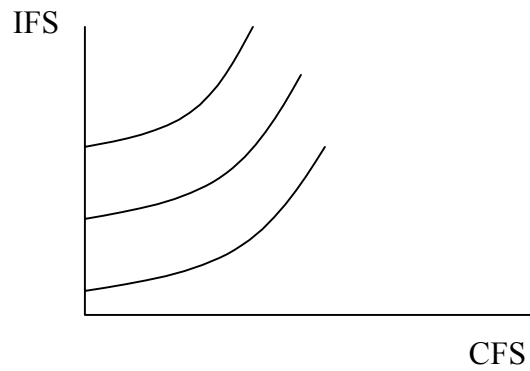
Thus, a good estimation of demand for Islamic financial services in the UK should involve differentiating these three types of attitudes towards Islamic finance.

Most of the past market research done for Islamic financial institutions ignores this differentiation and, consequently, tends to overestimate demand for Islamic financial services in the UK.

Other factors are indeed important but they are of more relevance when Islamic financial services are provided in a competitive environment (or at least when suppliers of Islamic financial services are sufficiently large in number).

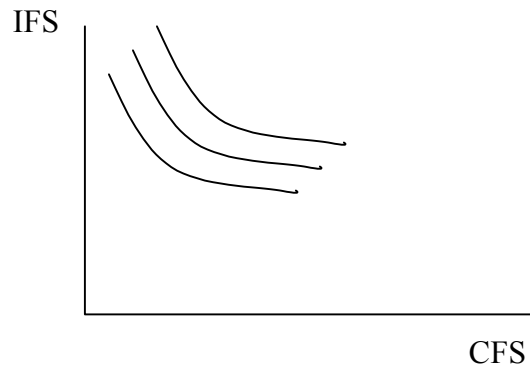
The unit \mathbf{d} merely estimates demand for conventional financial services, which is augmented with units \mathbf{o} and \mathbf{a} to estimate customers' willingness to switch to a provider of Islamic financial services. The multiplicative structure ensures that component z_{11} remains the most crucial factor in deciding to switch to Islamic financial services.

Figure 2a: Preferences of a staunch demander of Islamic financial services



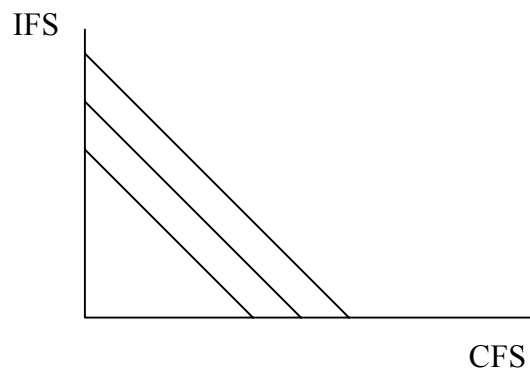
IFS: Islamic financial services (good); CFS: conventional financial services (bad)

Figure 2b: Preferences of a 'pent-up' demander for Islamic financial services



IFS: Islamic financial services (good); CFS: conventional financial services (good).
IFS and CFS are substitutes but consumer's preferences are tilted in favour of IFS.

Figure 2c: Preferences of a 'conventional' demander for Islamic financial services



IFS: Islamic financial services (good); CFS: conventional financial services (good).
IFS and CFS are perfect substitutes; only price matters.

4. EMPIRICAL RESULTS

4.1. The Demand Index

Based on this research methodology, we calculate a demand index different variants of which are presented in Table 2. As mentioned earlier, the demand index can take values between 0 and 1 to represent no and full demand, respectively. However, the average index value is only 0.118 (for the full sample) that marginally improves to 0.124 when students are excluded⁸. The respective figures show similar changes when credit cards are included in the sample⁹. Given this low average value of the index, if a threshold point of $\frac{1}{2}$ is chosen such that a person is a demander of Islamic financial services if the index value for them exceeds $\frac{1}{2}$ and no demander otherwise, this will leave us with very low demand for Islamic finance. One alternative is to use the average value of the index as a threshold, but perhaps a better threshold is the average value of the index for those who strongly believe in the prohibition of interest, which, on average, is 0.20 for our samples. Using this endogenous value of threshold, $\frac{3}{4}$ of the respondents are found to be at best indifferent to Islamic finance (see Table 3). Column 3 presents the summary statistics for the sample excluding students. It is evident that the inclusion of students does not change the sample behaviour significantly. Table 2 also shows the summary statistics of the sample including the use of credit cards by respondents. Again, there is no significant difference between the full sample and the one excluding students. Hence, inclusion of students in the sample does not result in a sampling bias.

The demand index offers interesting observations. Every fourth out of ten Muslims in the UK has some kind of demand for Islamic financial services. Table 3 divides the total sample into indifferent Muslims and pent-up and staunch demanders

of Islamic financial services. This classification is important, as it allows the providers of Islamic financial services to target the right groups of population for different market campaigns.

Table 2: Summary statistics of the demand index

| | Full sample | Excluding students | Full sample with credit card details | The sample with credit card details but excluding students |
|---|-------------|--------------------|--------------------------------------|--|
| Sample size | 503 | 424 | 503 | 424 |
| Mean | 0.118 | 0.124 | 0.126 | 0.131 |
| Maximum | 0.78 | 0.78 | 0.74 | 0.74 |
| Minimum | 0 | 0 | 0 | 0 |
| Threshold value | 0.19 | 0.20 | 0.20 | 0.21 |
| Potential demand: number and percentage | 124 (25%) | 106 (25%) | 140 (28%) | 115 (27%) |

Our survey suggests that social exclusion of Muslims with respect to financial services is exaggerated, as only about 5 percent Muslims are found to be staunch demanders of Islamic financial services. Indeed, about ¼ of Muslims tend to show preference for Islamic finance but a vast majority is still comfortable with mainstream financial services. Nevertheless, it is not undesired to increase the menu of financial services to cater for needs of wider communities, especially if some financial institutions are willing to offer community-based finance. This paper, however, strongly recommends such institutions to base their decision to enter into new markets like Islamic finance on reliable market research. Providers of Islamic financial services must realise that not all Muslims are practicing and may, in fact, be indifferent to the prohibition of interest. Even those who believe in this prohibition may not be fully aware of the alternatives available. Many Muslims tend to be sceptical of Shariah permissibility of even those financial products that have received approval of renowned Shariah scholars. For a glimpse of attitude of ordinary Muslims

towards Islamic finance, one may refer to the reaction to the launch of HSBC Ijara mortgages in the summer of 2003¹⁰. In our own survey, more than 50 percent are unsure about Islamicity of Islamic financial services. Only 17 percent perceive practice of Islamic finance only broadly Islamic and even a lesser 11 percent are satisfied with the Islamic financial products offered in the UK.

Table 3: Classification of demand

| | Full sample | Excluding students | Full sample with credit card details | The sample with credit card details but excluding students |
|--|-------------|--------------------|--------------------------------------|--|
| No demand ($D < 0.2$) | | | | |
| Number | 379 | 318 | 363 | 309 |
| (Percentage) | (75%) | (75%) | (72%) | (73%) |
| Pent-up demand ($0.2 \leq D \leq 0.5$) | | | | |
| (Number) | 104 | 86 | 117 | 92 |
| Percentage) | (21%) | (20%) | (23%) | (22%) |
| Staunch demand ($D > 0.5$) | | | | |
| (Number) | 20 | 20 | 23 | 23 |
| (Percentage) | (4%) | (5%) | (5%) | (5%) |

Table 4 presents estimated effective demand for Islamic financial services by the UK Muslims. Using the demand classification of Table 3, we attempt to estimate the number of Muslim individuals and households, which may demand Islamic financial services. The figures are based on the total Muslim population of 1.8 million out of which 60 percent is bankable¹¹; the estimated Muslim households in the UK are 500,000 (MCB).

Our dataset also allows us to estimate size of the market for Islamic mortgages in the country. Out of 503 respondents, only 45 respondents (9 percent of the sample) with positive attitude towards Islamic finance hold mortgages, with average borrowing of £65,467 per household. Assuming that the sample approximates the UK

Muslim population, then an estimated of 45,000 households can demand Islamic mortgages, giving rise to an estimated market for Islamic mortgages valuing about £3 billion¹².

Table 4: Effective demand for Islamic financial services: number and households

| | Full sample | Excluding students | Full sample with credit card details | The sample with credit card details but excluding students |
|----------------|-------------|--------------------|--------------------------------------|--|
| Pent-up demand | | | | |
| Number | 226,800 | 216,000 | 248,400 | 237,600 |
| Households | 105,000 | 100,000 | 115,000 | 110,000 |
| Staunch demand | | | | |
| Number | 43,000 | 54,000 | 54,000 | 54,000 |
| Households | 20,000 | 25,000 | 25,000 | 25,000 |
| Total | | | | |
| Number | 269,800 | 270,000 | 302,400 | 291,600 |
| Households | 125,000 | 125,000 | 140,000 | 135,000 |

4.2. Factors Affecting Demand for Islamic Financial Services

It is important to find out what factors may influence demand for Islamic financial services in the UK. For this purpose, we estimate a Logit model of the following form:

$$L_i = \ln\left(\frac{P_i}{1-P_i}\right) = \alpha + \beta_i \sum x_i + u_i$$

where $\frac{P_i}{1-P_i}$ is the odd ratio in favour of demanding Islamic financial services and x_i are the independent variables¹³.

Table 5 presents the results of estimation. It shows that four factors, namely education, occupation, location and income are significant determinants of demand for Islamic financial services. Other factors like age, gender, ethnicity and marital

status are not statistically significant. While education, occupation¹⁴ and income level positively affect demand for Islamic financial services, location (lowest value for the northern most city (Manchester) and highest for the southern most (London)) shows a negative relationship with the demand. The latter is an interesting result and it is worthwhile looking into the dataset for a breakdown of the incidence of demand in different cities surveyed. Table 6 classifies demand for Islamic finance into pent-up and staunch demand in major cities. It is clear that demand as a percentage of people surveyed goes down as we move southwards (see also Figure 3 below). This implies that per capita demand for Islamic finance is expected to be less than in the south, given that bulk of Muslim population lives in London and its suburbs. All the variables are statistically significant at 5 percent level (except occupation that shows significance at 7 percent). The estimated coefficients, however, are very small, implying that the marginal effects of changes in independent variables on the incidence of demand are rather limited.

Table 5: Logit maximum likelihood estimation

| The estimation method converged after 5 iterations | | | |
|--|-------------|----------------|-----------------------|
| Dependent variable is Li (=1 for demand; =0 for otherwise) | | | |
| 503 observations used for estimation from 1 to 503 | | | |
| Regressor | Coefficient | Standard error | T-ratio (probability) |
| Constant | -1.3081 | 0.54578 | -2.3967 (0.017) |
| Education | 0.34396 | 0.10510 | 3.2727 (0.001) |
| Occupation | -0.04920 | 0.024044 | -1.7851 (0.075) |
| Location | -0.10970 | 0.034642 | -3.1666 (0.002) |
| Income level | 0.19638 | 0.10010 | 1.9618 (0.050) |
| Factor for the calculation of marginal effects = 0.19304 | | | |
| Maximised value of the log-likelihood function = -277.1422 | | | |
| Akaike information criterion = -282.1422 | | | |
| Schwarz Bayesian criterion = -292.6936 | | | |
| Hannan-Quinn criterion = -286.2815 | | | |
| Mean of Demand = 0.27833 | | | |
| Mean of fitted Demand = 0.067594 | | | |
| Goodness of fit = 0.72962 | | | |
| Pesaran-Timmermann test statistics = -65.2394 (0.000) | | | |
| Pseudo-R-Squared = 0.068300 | | | |

Table 6: Incidence of demand for Islamic finance in major cities

| | Pent-up demand | Staunch demand | Total* |
|------------|----------------|----------------|----------|
| Manchester | 22 | 3 | 25 (41%) |
| Nottingham | 11 | 1 | 12 (25%) |
| Leicester | 12 | 2 | 14 (23%) |
| Birmingham | 5 | 2 | 7 (13%) |
| Luton | 9 | 0 | 9 (21%) |
| London | 19 | 2 | 21 (19%) |

* Figures in parentheses show the demand as a percentage of people surveyed in different cities.

In order to illustrate the results, we offer inter-city comparison of demand, which reveals some interesting observations. For example:

- A Manchester-based upper management professional with postgraduate qualification and earning more than £56,000 per annum is about three times more likely to consume Islamic financial services than being indifferent to Islamic finance. On the other side, a London-based upper management professional with similar credentials is likely to be at best indifferent to Islamic finance.
- Similarly, a Manchester-based person with degree-level education, intermediate occupation¹⁵ and earning between £26,000 and £35,000 will at best be indifferent to Islamic finance. A London-based person with similar traits is 3-times more likely not to consume Islamic financial services than demanding them.

Figure 3 compares incidence of demand for Islamic finance in some of the cities included in our survey. The upper set of plotted data refers to an individual with postgraduate qualifications, an upper management job and income in excess of £56,000. The lower set of data is plotted for an individual with education up to first-degree level, intermediate occupation and income between £26,000 and £35,000. As

the figure shows, there is evidence that demand for Islamic financial services tends to go down as we move southwards. Why? One possible explanation is that the Muslim communities in the north are more closely-knit and conservative. As the religious influence tends to be more in such environments, there is more demand for Islamic finance in the north than in the south. Also, the highly educated with top-level jobs and high incomes are more likely to consume Islamic financial services; the less educated with low earnings are less likely to demand such services.

Table 7 highlights the likelihood of incidence of demand for Islamic financial services across different income groups in some major cities included in the survey. The data refers to profile of a person with a degree-level qualification and intermediate occupation. A value of more than 1 suggests that for a person profiled above is more likely to demand for Islamic financial services than not having demand at all. Thus, for example, the value of 1.63 (in the bottom of column 2) means that a Manchester-based person possessing degree level qualification, on an intermediate occupation and earning more than £56,000 per annum is 1.63 times more likely to exhibit demand for Islamic financial services than not having any interest in Islamic finance. A similar person located in Birmingham, Luton or London is unlikely to be interested in Islamic finance. It is, therefore, important to identify right people for market targeting. Shaded values refer to staunch demand for Islamic financial services; the values less than 1 but not too low (say between 81 and 99; in italics) may be taken as to imply some pent-up demand for Islamic financial services. The results suggest that our person will not consume Islamic financial services if they are located in the south. A typical degree-holder Muslim on an intermediate occupation earning less than £26,000 is unlikely to be interested in Islamic finance.

Figure 3: Incidence of demand: north-south differences

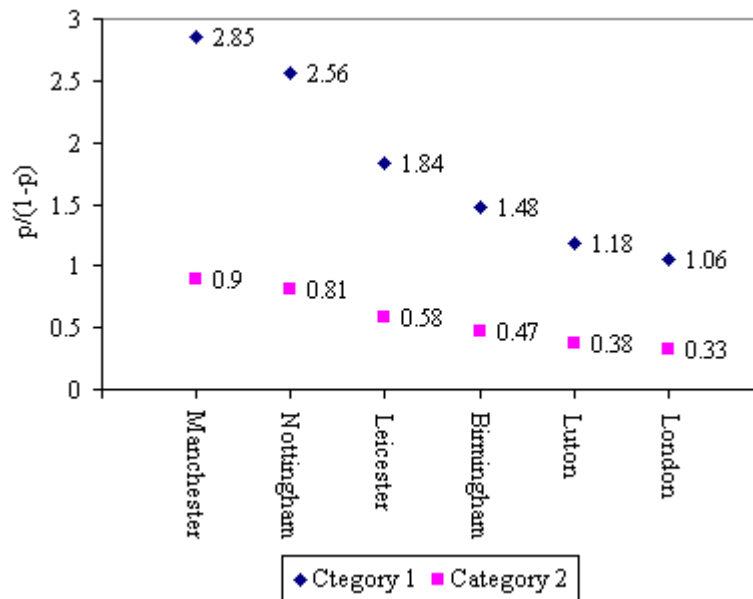


Table 8 presents likelihood of demand for Islamic finance by a representative Muslim on an intermediate occupation and earning £26,000-£35,000. It is clear from the table that demand for Islamic financial services lies among educated Muslims. The Muslims with university experience are more likely to be customers of the institutions offering Islamic finance.

Table 9 compares the incidence of demand for Islamic finance across a range of occupations. Again, there is evidence that those on higher professions and occupations are more interested in Islamic finance than those on the lower side of the rung. This is probably because professional and others on higher occupations are more educated than others and, hence, more exposed to Islamic finance.

Table 7: Likelihood of demand for Islamic finance by a degree-holder on an intermediate occupation

| Income | Manchester | Nottingham | Leicester | Birmingham | Luton | London |
|----------------|------------|------------|-----------|------------|-------|--------|
| Less than £15K | 0.61 | 0.54 | 0.39 | 0.31 | 0.25 | 0.23 |
| £15K-£25K | 0.74 | 0.67 | 0.48 | 0.38 | 0.31 | 0.28 |
| £26K-£35K | 0.91 | 0.81 | 0.58 | 0.46 | 0.38 | 0.34 |
| £36K-£45K | 1.10 | 0.98 | 0.71 | 0.57 | 0.46 | 0.41 |
| £46K-£55K | 1.34 | 1.20 | 0.86 | 0.69 | 0.56 | 0.50 |
| £56K and over | 1.63 | 1.46 | 1.05 | 0.85 | 0.68 | 0.61 |

Based on Logit model presented in Table 5

Table 8: Likelihood of demand for Islamic finance by someone with an intermediate occupation and earning £26K-£35K per annum

| Education | Manchester | Nottingham | Leicester | Birmingham | Luton | London |
|---------------------------|------------|------------|-----------|------------|-------|--------|
| Informal/vocational | 0.46 | 0.41 | 0.29 | 0.24 | 0.19 | 0.17 |
| High school/Diploma | 0.64 | 0.56 | 0.41 | 0.33 | 0.27 | 0.24 |
| First degree | 0.90 | 0.81 | 0.58 | 0.47 | 0.38 | 0.34 |
| Postgraduate/professional | 1.27 | 1.14 | 0.82 | 0.66 | 0.53 | 0.48 |

Based on Logit model presented in Table 5

Table 9: Likelihood of demand for Islamic finance by a degree-holder earning £26K-£35K per annum

| Occupation | Manchester | Nottingham | Leicester | Birmingham | Luton | London |
|---|------------|------------|-----------|------------|-------|--------|
| Employers in large organisations | 1.17 | 1.05 | 0.76 | 0.61 | 0.49 | 0.44 |
| Higher managerial | 1.12 | 1.01 | 0.72 | 0.58 | 0.47 | 0.42 |
| Higher professional | 1.08 | 0.96 | 0.70 | 0.56 | 0.45 | 0.40 |
| Lower professional and higher technical | 1.03 | 0.92 | 0.66 | 0.53 | 0.43 | 0.38 |
| Lower managerial | 1.00 | 0.88 | 0.64 | 0.51 | 0.41 | 0.37 |
| Higher supervisory | 0.95 | 0.85 | 0.61 | 0.49 | 0.39 | 0.35 |
| Intermediate | 0.91 | 0.81 | 0.58 | 0.47 | 0.38 | 0.34 |
| Employer in small organisations | 0.87 | 0.78 | 0.56 | 0.45 | 0.36 | 0.32 |
| Own account workers | 0.83 | 0.75 | 0.54 | 0.43 | 0.35 | 0.31 |
| Lower supervisory | 0.80 | 0.71 | 0.51 | 0.41 | 0.33 | 0.30 |
| Lower technical | 0.76 | 0.68 | 0.49 | 0.39 | 0.32 | 0.28 |
| Semi-routine | 0.73 | 0.66 | 0.47 | 0.38 | 0.30 | 0.27 |
| Routine | 0.70 | 0.61 | 0.45 | 0.36 | 0.29 | 0.26 |
| Unemployed | 0.67 | 0.60 | 0.43 | 0.35 | 0.28 | 0.25 |
| Full time students | 0.64 | 0.57 | 0.41 | 0.33 | 0.27 | 0.24 |

Based on Logit model presented in Table 5

5. STRATEGIC IMPLICATIONS AND CONCLUSIONS

The survey reveals that $\frac{3}{4}$ of the UK Muslims are at best indifferent to Islamic finance, implying that demand for Islamic financial services may not be a purely

religious phenomenon. Thus providers of Islamic finance cannot put a significantly large premium on the Shariah compliance that in itself is questioned by a majority of Muslims (83 percent of the surveyed). While this perception (of un-Islamicity) may very well be because of widespread unawareness of Islamic finance amongst Muslims, it is, nevertheless, an important issue bearing significant relevance to the demand for Islamic financial services. It is vital to understand that Islamic finance is at best a 'supply-led' phenomenon in the UK, implying that the institutions offering Islamic financial services will have to *create* demand as there may not be an *automatic* demand for their products. This is clearly evidenced by only 5 percent staunch demand in the UK.

Increasing awareness of benefits of switching to Islamic finance can push up the demand. Mere offering of Shariah-compliant or Halal services may not be sufficient – other tangible benefits must be attached to such services. One area of focus is international money transfer service. As most Muslims living in the UK have strong family links with countries of their origin, they transfer money abroad quite frequently. A bank charging a competitive price for providing money transfer service is bound to attract Muslim customers who frequently send money abroad. This important market remains under-explored even in countries like Bahrain (where Islamic banking has otherwise grown rapidly in the recent past) with large number of expatriates [see Metawa and Almosawi, 1998].

Regional variation in demand is an important consideration for marketing Islamic financial services. In the past, there has been a focus on London perhaps because of it being an international financial centre. However, there seems to be greater demand for Islamic finance in the north, necessitating a re-orientation of marketing strategy for providers of Islamic financial services.

Perhaps the most important finding of this research is a positive association between income level and demand for Islamic finance. A typical consumer of Islamic finance is someone with university education, on an upper management/professional job with high income and located in the central England or north of the country. For trickling down of the demand to lower incomes, professions and occupations and the less educated will be a major challenge to the providers of Islamic finance.

The big four banks, i.e., HSBC, Barclays, Natwest and Lloyds TSB, are less competitive in terms of pricing of their deposit accounts, as evidenced by consistently lower rates of interest paid on current accounts and instant savings accounts and higher rate of interest charged on (pre-agreed) overdrafts as compared to the other institutions in the industry. In the recent past, building societies (or ex building societies) have gained market share of financial services at the expense of the Big Four [Gondat-Lerralde and Nier, 2004] and there is no reason that an Islamic bank cannot do the same, provided that it adopts the correct marketing strategy.

¹ Others include Al-Buraq (Islamic financial services offered by ABC International Bank), Ansar Finance and some other small players.

² Although HSBC Amanah Finance launched its retail Islamic financial products in the UK recently, but it is still too early to comment on its performance.

³ There has been regular coverage of Islamic finance, particularly Islamic mortgages, on electronic and print media in the UK.

⁴ The surveyors were instructed to avoid any direct questions on the religious affiliation/inclination of the respondents. Individuals were approached in the pre-dominantly Muslim neighbourhoods and if, during the interview, a person was found non-Muslim the questionnaire was discarded.

⁵ The surveyors were instructed not to tell any benefits of Islamic financial services when explaining differences between Islamic and conventional finance. They were also asked not to emphasise on the prohibition of interest, as this was expected to inflate respondents' aversion to interest. The objective was to make the respondents reveal their attitude towards Islamic finance based on their pre-interview awareness of Islamic finance.

⁶ Thus, someone showing strong desire for Islamic finance may not have demand for Islamic financial services if they actually do not use banking services at all.

⁷ Our methodology is similar to Lancaster's approach to consumer preferences [Lancaster, 1996], which asserts that consumers seriously consider the characteristics that make up a good, before deciding to purchase.

⁸ Incidentally, 79 of 503 respondents happen to be students who may not represent typical behaviour of the UK bankable population.

⁹ We construct the unit 'd' with and without credit card payments (x_6) to see if there is some difference in demand but find that the two indices are comparable. The former is perhaps better as it uses more information than the latter.

¹⁰ Out of 16 postings on <http://www.findaproperty.co.uk> in response to an article on HSBC Ijara mortgage, only 2 were happy with it; 11 criticised it on Shariah grounds while 3 were either indifferent or not happy with its pricing.

¹¹ The 2001 Census suggests that about 38% of the UK Muslims lie below the age of 16 (ONS). We estimate the about 40% UK Muslims are aged 18 or below. Thus 60% of the UK Muslims (1,080,000) are bankable.

¹² This figure is significantly less than the Datamonitor's estimation of £4.5 billion by 2006. However, with the increase in number of suppliers of Islamic mortgages (HSBC, United National Bank, Islamic Bank of Britain and soon ABC International Bank as opposed to just one provider, i.e., Ahli United Bank, at the time of Datamonitor's estimation), one may expect that the figure of £4.5 billion is quite realistic.

¹³ x_i in this equation has no relations with the x_i used in the construction of demand index.

¹⁴ The variable Occupation is based on the National Statistics Socio-economic Classification.

¹⁵ Occupation takes 17 values, 1 for the highest profession (employers in large organisations) and 17 for the lowest. The variable used in the Logit analysis has a negative sign, suggesting that higher the profession (lower the number), more is the demand for Islamic financial services.

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